IN THE

SUPREME COURT

OF THE UNITED STATES

OCTOBER TERM, 1947

PORTER ROYALTY POOL, INC.
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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CITATIONS

STATUTES AND REGULATIONS

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TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

JOHN C. EVANS, Esq., on behalf of PORTER ROYALTY POOL, INC., petitioner, prays that a Writ of Certiorari issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit entered in the above entitled action on February 3, 1948, affirming the decision of the Tax Court of the United States entered November 14, 1946.

Opinions Below

The opinion of the Tax Court of the United States is reported in 7 T.C. 685. The opinion of the Circuit Court of Appeals for the Sixth Circuit is reported in 165 Fed. (2nd) 933.

Jurisdiction

Jurisdiction is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925; 28 U.S.C.A. Section 347; 43 Stat. 938.

The decision which petitioner seeks to have reviewed was handed down by the Circuit Court of Appeals for the Sixth Circuit on February 3, 1948.

Statement

The Commissioner of Internal Revenue assessed a deficiency in the amount of $70.81 in petitioner's income tax for the calendar year 1940; and also a deficiency in the amount of $45,975.12 in petitioner's income tax, and in the amount of $3,461.60 in petitioner's excess profits tax, for the calendar year 1941.

The petitioner contended in its petition to the Tax Court that it was not properly liable for any of said deficiencies, and further that it was entitled to a finding of over-assessment of its income tax for the calendar year 1941 in the amount of $128,021.98, and of excess profits tax for the calendar year 1941 in the amount of $9,338.63.

The Tax Court in its decision found that there are deficiencies in petitioner's income tax for the calendar years 1940 and 1941 in the respective amounts of $70.81 and $49,943.20; and that there is an over-assessment in petitioner's excess profits tax for the calendar year 1941 in the amount of $9,338.63.

This decision of the Tax Court was affirmed by the Circuit Court of Appeals for the Sixth Circuit.

Petitioner is a corporation organized and existing under the laws of the State of Michigan (R.45). It filed a corporate income tax return for the year 1941 (R.45) which return contained a denial of liability for tax (R. 158-159). It also filed a partnership return for 1941 (R. 141-151). For the year 1940, a partnership return was filed (R. 132-140).

Certain fee owners of land located in the Township of Porter, County of Midland, State of Michigan, each executed an oil and gas lease as lessor, with certain persons or corporations as lessee (R. 45).

Each of the fee-owner lessors entered into a certain pooling agreement whereby he assigned to named individuals as trus-

tees one-half of his royalty interest, that is to say, to the extent of an undivided one-sixteenth interest in and to all the oil and/or gas produced from his lands (R. 45, 57). These pooling agreements (Exhibits 2, pages 57-59) provided:

(*a*) That when a well had been discovered on any of the lands covered by the pooling agreements from which oil and gas would be produced in commercial quantities, the trustees should then forthwith assign all the royalty interests acquired by them as trustees under these pooling agreements to a corporation to be organized (R. 58).

(*b*) That upon the formation of the corporation, its common stock would be issued to the said fee-owner lessors who were signatories to the pooling agreements in proportion to their respective contributions to the pool (R. 58).

(*c*) That the promoters, in consideration of their services in forming the pool and agreeing to pay all of the expenses of the formation of the pool, were to receive 25% of the common capital stock of the corporation (R. 58).

(*d*) That the trustees were not liable to see to the recording of any instrument, nor to take any action to protect the interest in the lands and property, nor have any responsibility as to the validity of the instrument or of any agreement for royalty in or to oil and/or gas produced from the lands, nor as to the execution or acknowledgment of the same, nor as to the title of the assignors of such oil and gas leases (R. 58).

(*e*) That the trustees were absolved from all duty to pay, or to keep themselves informed as to the payment of taxes or assessments upon the property and were absolved from the obligation to take any action toward the execution or enforcement of the trust which might involve them in any expense or liability (R. 58, 59).

(*f*) That the articles of incorporation and by-laws of the proposed corporation should provide that the proceeds of any and all oil and gas due as royalties on any of the lands affected by the pooling agreement when received by the corporation should be used solely for the following purposes:

"(A) For the necessary expenses incurred in connection with the management and operation of said corporation; and

"(B) For dividends to the stockholders of such corporation to be formed; and

"(C) That the officers and directors to be elected as such by the stockholders of said corporation shall serve without salary or remuneration" (R. 59).

(*g*) That the articles of incorporation of the proposed corporation should contain the following purpose clause:

"The purpose of this corporation is to own royalty in oil and gas lands and leases; to pay mortgages, notes, taxes, assessments, and other charges that are or may become a lien or charge against any lands or leases in which this company may have a royalty interest" (R. 59).

Thereafter, in accordance with the terms of the pooling agreements, Porter Royalty Pool, Inc. was duly incorporated under the laws of the State of Michigan on May 2, 1933 (R. 60-63). The purpose clause of the articles of incorporation recited as follows:

"The purpose of this corporation is to own royalty in oil and gas lands and leases; to pay mortgages, notes, taxes, assessments, and other charges that are or may become a lien or charge against any lands or leases in which this company may have a royalty interest. (In general to carry on any business in connection therewith and incident thereto not forbidden by the laws of the State of Michigan and with all powers conferred upon corporations by the laws of the State of Michigan.)" (R. 61).

On May 10, 1933, the by-laws of Porter Royalty Pool, Inc. were duly adopted (R. 66-76).

Paragraph 14 of said by-laws provided for the issuance of the stock of the corporation subject to certain rights and privileges which shall be written or printed plainly on the face of each certificate as follows (R. 72-73):

"(1) This corporation hereby reserves the right to apply all dividends that may be declared, applicable to

this stock certificate upon any debt due or owing by the record holder thereof to this corporation.

"(2) The consideration for the issuance of this stock certificate is the assignment or conveyance of a——— interest in the oil and/or gas royalties upon the following described premises, to-wit: (Here insert on each stock certificate the description of the land upon which said assignment has been given), and in which said assignment it is agreed that a good merchantable title to said oil and/or gas royalties is to be conveyed and assigned.

"(3) Now, therefore, if for any reason said title so conveyed as aforesaid is not a good merchantable title, and this corporation by reason of the existence of any encumbrance or lien having priority to the rights of this corporation which shall be allowed to become past due and unpaid, either in principal or interest, or if any action shall be commenced or threatened, which if successful, might extinguish the title of the corporation to said oil and/or gas royalties so assigned, then in that case, this corporation hereby reserves the right to apply all the dividends applicable to this certificate of stock, to the payment of any such encumbrance or lien, or to the expense of protecting the title to said oil and/or gas so assigned as aforesaid, and if for any such reason, this corporation loses its interest in oil and/or gas royalties so conveyed and assigned as aforesaid, then thereafter no further dividends shall be declared or paid on this certificate of stock, and the holder thereof shall lose the right to, and be debarred from voting this certificate, and from other participation in the affairs of this corporation by reason of the holding of this certificate.

"(4) If the owner, or the grantee of the owner of the land upon which the said oil and/or gas royalties have been conveyed to this corporation, or if this corporation shall pay all or any part of any encumbrance upon said land, then, and in that case, all stock issued in consideration of said oil and/or gas royalties assigned shall be affected equally by said payment."

Paragraph 17 of said by-laws recited that, after the payment of all current expenses including taxes and franchise fees, the balance of the receipts shall be voted and paid to the stock-

holders at the end of each fiscal month; provided, however, that $200.00 could be retained in the treasury after each distribution (R. 74).

Paragraph 20 of said by-laws provided:

(I) That each stockholder shall have exclusive right to enter into any drilling contract for his own land, and to collect and retain all rentals, bonuses and revenue of a private nature, provided it does not impair the rights of the corporation in and to the oil and/or gas royalty and rights assigned to the corporation (R. 75).

(II) That the Board of Directors shall not use any money belonging to the corporation for paying any indebtedness on the land, except out of the dividends payable to the owners of such lands, and then only past due indebtedness on such lands, such as interest or principal of mortgages, or contracts, or taxes, or liens that may jeopardize the safety of the property (R. 75).

(III) That no properties can be added and stock given for the same after the incorporation of the company except by unanimous vote of the stockholders (R. 75).

(IV) That the owner of the land may mortgage the surface rights of the land so long as the royalty assigned to the pool is exempted from the mortgage (R. 75).

Paragraph 22 of said by-laws provided that the annual management and operating expenses of the corporation shall not exceed $1,500.00, except for litigation or legal fees (R. 75).

Paragraph 23 of said by-laws provided that a copy of the pipeline run shall be sent or mailed to each stockholder of record monthly (R. 76).

On June 16, 1933, the trustees named in the various pooling agreements, executed assignments of their interest under each of said pooling agreements to Porter Royalty Pool, Inc. The said assignments were duly recorded in the office of the Register of Deeds for Midland County, Michigan, on July 18, 1933 (R. 46, 77-79).

Thereafter, Porter Royalty Pool, Inc., issued stock certifi-

cates to the persons entitled thereto under its articles of association and by-laws, which certificates contained on the face thereof the provisions called for by article 14 of the by-laws (R. 46, 80).

Thereafter, Glenn R. Hathaway and Mildred J. Hathaway, who had executed one of the pooling agreements, filed a bill of complaint in Chancery in the Midland County Circuit Court, alleging fraud and misrepresentation in the organization of the pool and a violation of the Blue Sky Law in the organization of Porter Royalty Pool, Inc. Said suit prayed rescission of the pooling agreement and for an accounting. The pipeline companies purchasing the oil produced under the various leases were made parties defendant. Subsequently, other fee-owner lessors, who had signed the pooling agreements, joined as plaintiffs, and Porter Royalty Pool, Inc., filed a cross bill in said action. The Circuit Court entered its decision adverse to Porter Royalty Pool, Inc., and ordered the cancellation of the pooling agreements (R. 47-48).

Porter Royalty Pool, Inc., appealed from said decision to the Michigan Supreme Court, which rendered its original opinion on January 6, 1941, and filed an amendatory opinion on July 30, 1941 (R. 81-103). The Supreme Court, in its opinion, found:

> (*a*) That the original pooling agreement between the parties constituted a joint adventure (R. 99).
>
> (*b*) That the formation of the corporation in no way changed the intended relationship of joint adventure (R. 99).
>
> (*c*) That the purpose of the corporation "was not to conduct a business for profit, but to effectuate a distribution of royalties—merely to hold the pooled rights and to carry out the agreement of the parties as to their participation in the proceeds. No stock could be issued to anyone except to one of the joint adventurers, and all that the joint adventurers could receive from the corporation were the proceeds from the property that they had pooled with the others (R. 94) * * * If it be the manifest intention of the

parties to enter upon a joint adventure, the employment of the corporate mechanism and the issuance of stock do not negative the existence of such relation (R. 95) * * * The corporate form was not essential or necessary to effectuate the joint adventure; a trustee could have been used as the medium * * *; the corporate form was determined upon to carry out the purposes of the joint adventure; it was not the joint adventure that was determined upon to carry out the purposes of the corporation. The corporation was the adjunct of the joint adventure (R. 98) * * *. The certificates issued in the instant case are unique as stock certificates. They recite the consideration for which they are issued, namely the assignment of the interest in oil royalties in the described lands owned by the certificate holder; they provide that if by prior encumbrance or lien the corporation should lose its interest in the royalties the stockholder will no longer share in the proceeds of the pool and be debarred from voting rights (R. 98) * * * it is our conclusion that the agreement in question was an agreement for a joint adventure; that the formation of the corporation pursuant to the agreement in no way changed the relationship of joint adventure between the parties; that the agreement for the use of the corporate medium was only a convenient method of carrying into effect the joint adventure, and was not a contract prohibited by the Blue Sky Law; that the issuance of stock by the corporation to the pool members was not the sale of securities within the intendment of the statute" (R. 99, 100).

On April 24, 1941, the Michigan Supreme Court entered its original decree in said cause (R. 103); and on October 31, 1941, its amended final decree in accordance with its opinion and amendatory opinion (R. 104). That decree made findings as to the legal relationship of the parties; the legal nature of the rights created by the pooling agreements; and that the agreement for the use of the corporate medium and the organization of the corporation was only a convenient method for carrying into effect the joint venture enterprise. The decree ordered that the proceeds of the pooled oil impounded up to July 31, 1941, amounting in all to $787,993.79, be paid over to

Porter Royalty Pool, Inc., and that all pooled oil or proceeds thereof accruing subsequent to July 31, 1941, be likewise paid over to that corporation (R. 112-114).

The said impounded sum of $787,993.79, plus other royalty moneys received, including those for the period from August 1, 1941, to December 31, 1941, made gross receipts for the company in the calendar year 1941 of $825,075.21, which amount was reported as royalties received by Porter Royalty Pool, Inc., on its income tax returns for the calendar year 1941 (R. 49, 50). These royalty moneys were the entire gross income reported by the petitioner on its income tax return for 1941 (R. 141, 157).

THE QUESTION PRESENTED

DID THE PETITIONER, CREATED PURSUANT TO THE TERMS OF THE POOLING AGREEMENT, POSSESS ANY PROPRIETARY RIGHT, TITLE OR INTEREST IN THE PROCEEDS OF THE ASSIGNED ROYALTY OIL, SO THAT SUCH PROCEEDS WHEN RECEIVED WERE TAXABLE INCOME TO THE PETITIONER?

Statutes and Regulations Involved

Internal Revenue Code, Sec. 22(a). Gross Income.

"(*a*) GENERAL DEFINITION.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included

in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income."

(26 U.S.C. 1940 Ed., Sec. 22)

Internal Revenue Code, Sec. 181. Partnership Not Taxable.

"Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."

(26 U.S.C.A. 1940 ed., Sec. 181)

Internal Revenue Code, Sec. 182. Tax of Partners.

"In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * *

"*(c)* His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b)."

(26 U.S.C. 1940 ed., Sec., Sec. 182)

Sec. 3797. Definition

"*(a)* When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * *

"(2) Partneship and Partner. The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term 'partner' includes a member in such a syndicate, group, pool, joint venture, or organization."

(26 U.S.C. 1940 ed., Sec. 3797)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

"Sec. 19.22(a)-1. *What included in gross income.*— Gross income includes in general compensation for personal and professional services, business income, profits

from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law.*** In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.***"

"Sec. 19.181-1. *Partnerships* — Partnerships as such are not subject to taxation under the Internal Revenue Code, but are required to make returns of income.***"

"Sec. 19.182-1 (as amended by T. D. 5217, 1943 Cum. Bull, 314, 336) *Distributive share of partners.*—(a) Each partner is required to include in his return for his taxable year within which or with which the taxable year of the partnership ends, whether or not distributed:

(1) For any taxable year beginning after December 31, 1938, and before January 1, 1942, as part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership; and for any taxable year beginning after December 31, 1941, as part of his gains and losses from sales or exchanges of capital assets held for not more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months.

(2) For any taxable year beginning after December 31, 1938, and before January 1, 1942, as part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership; and for any taxable year beginning after December 31, 1941, as part of his gains and losses from sales or exchanges of capital assets held for more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than six months.

(3) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b)."

Specification of Errors to be Urged

1. The decision of the Circuit Court of Appeals is erroneous

in that under the stipulated facts the petitioner was a mere conduit and adjunct of the pool for the sole purpose of distributing the proceeds of the pooled royalty oil to the pool members.

2. The Circuit Court of Appeals erred in failing to find that the written pooling agreement, pursuant to which petitioner was created, constituted the petitioner merely an agent and conduit for the collection and distribution of the royalty oil proceeds.

3. The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Reasons Relied Upon For Writ

The Circuit Court of Appeals for the Sixth Circuit has decided a Federal question in a manner in conflict with applicable Decisions of this Court, of other Circuit Courts of Appeals, and of the Tax Court of the United States.

The opinion of the Court below, in deciding this phase of the case presented, said only this:

> "Petitioner further contends that it was simply the agent of the landowner-lessors to collect the income. We think this contention is without merit. It finds no support in the agreements between the parties. It is in conflict with the generally accepted idea that a corporation is an entity and with the evidence in the case that it was acting in its own behalf. See *Moline Properties v. Commissioner,* 319 U.S. 436."

The case below was tried upon a stipulation of facts (R. 44). There was no additional testimony or evidence offered by either of the parties (R. 35-44).

That stipulation clearly shows that by the pooling agreements the only function of the corporation, which was to be created if and when oil was produced upon any of the lands covered by those agreements, was purely *a trustee or agency function.* The corporation was the successor to the *individual*

trustees named as such in all of the pooling agreements (Ex. 2, R. 57).

This Court in its *Moline Properties, Inc.*, decision said:

> "Petitioner advances what we think is basically the same argument of identity in a different form. It urges that it is a mere agent for its sole stockholder and 'Therefore the same tax consequences follow as in the case of any corporate agent or fiduciary.' There was no actual contract of agency, nor the usual incidents of an agency relationship. Surely the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders. Therefore the question of agency or not depends upon the same legal issues as does the question of identity previously discussed."

The contract, under which and strictly subject to which the petitioner received the one-sixteenth of the oil produced from the lands of the fee-owner lessors, *is the pooling agreement* (R. 57). Whatever rights passed from those fee-owner lessors to the Trustees of the pool are found in, and are defined and limited by, that pooling agreement. Those pooling agreements are in writing and recorded as permanent public documents in the office of the Register of Deeds for Midland County, Michigan.

The assignment of the pooling agreements by the Trustees to petitioner are also written and recorded public documents (R. 78).

In the event that no oil or gas was found in any of the lands of the fee-owner lessors within five years, then the Trustees were to surrender and cancel the pooling agreements. (Article 2, R. 57-58). In the event that oil was found upon any of such lands, then the Trustees were obligated, within ninety days of such discovery, to form a corporation to be known as Porter Royalty Pool, Inc., to which the pooling agreements were to be assigned by the Trustees (R. 58). The name of this

corporate agency was provided for; those who would become its stockholders, and a formula for determining the amount of stock each would receive, were clearly defined; its functions and method of operation, after it should come into existence were specifically outlined and limited (R. 59). The corporation to be formed could use its receipts only for the necessary expenses of its operation and for dividends to stockholders. It was also provided that no officer or director should be paid any salary or remuneration (R. 59).

The Trustees of the pooling agreement did organize the corporation provided for in that agreement promptly after the first discovery well was brought in as a commercial producer. The corporation articles are dated April 28, 1933, and were filed May 2, 1933 (R. 63). The assignments to the corporation from the Trustees were recorded July 18, 1933 (R. 78). The by-laws of the corporation (R. 66-76) faithfully in all respects reflect the conditions and limitations set forth in the pooling agreements. They provide specifically that any by-law contrary to the provisions of the pooling agreements is void and of no effect (R. 75). The by-laws limit management and operating expenses to $1,500.00 per year, except litigation and legal advice (R. 75). It is provided that the stock certificates to be issued should contain the unusual recitals as to the consideration for which the stock is issued and as to the reserved rights of the corporation (R. 72). The stock certificates when issued complied with this requirement (R. 80). It was further provided that all receipts must be distributed at the end of each month (Article 17, R. 74).

In addition to this showing of a *contract pre-dating the bringing of the corporation into existence,* there is also the adjudication of the Supreme Court of Michigan as to the nature, purpose and limitations of the petitioner's corporate existence and activity. That court held as follows (R. 93-94):

> "The corporation, Porter Royalty Pool, was organized under the laws of this State * * * for the purpose of creating a legal entity which would serve as a practical

> and convenient medium *to carry out the joint-adventure enterprise and agreement. The organization of the corporation was authorized by the joint-adventure agreement between the parties and such corporation was properly organized.*
>
> "The purpose of the corporation was not to conduct a business for profit, but to effectuate a distribution of royalties—*merely to hold the pooled rights and to carry out the agreement of the parties as to their participation in the proceeds.*" (Italics supplied.)

It is submitted that the stipulated facts show beyond any question of doubt that there was *a definite, explicit contract of agency between the petitioner and its stockholders;* that this contract *preceded the creation of this petitioner;* and that the petitioner was brought into being and *has functioned only in accordance with that original agreement.*

The pooling agreement created an express trust relationship between the members of the pool as to the disposition of the proceeds of the assigned oil. The assignment of the pooling agreements by those Trustees to petitioner was not in derogation of that trust relationship; it was in exact compliance with the terms of the trust.

We submit that under the stipulated facts herein the decision of the Sixth Circuit Court of Appeals is a clear misapplication of the *Moline Properties, Inc.,* decision.

The decision below is also in clear conflict with the following decisions in the Fifth Circuit and the Court of Appeals for the District of Columbia, respectively:

> *112 West 59th Street Corporation vs. Helvering,*
> 68 Fed. (2nd) 397.
> *Commissioner vs. Turney,* 82 Fed. (2nd) 661.

The Tax Court of the United States has had occasion since the *Moline Properties, Inc.* decision in 1943, to consider and apply that decision in a number of cases. The following cases involve that application to factual situations which cannot

be distinguished in principle from the case of this petitioner:

Worth Steamship Corporation, 7 T.C. 654
Industrial Union Oil Company; a memorandum opinion reported as C.C.H. Dec. 15, 440 (M) at 5 T.C.M. 879.
Silver Bluff Estates, Inc.; a memorandum opinion reported as C.C.H. Dec. 15, 869 (M) at 6 T.C.M.

We also cite the following cases of the Tax Court or its predecessor to the same effect:

Parish-Watson & Co., Inc., 2 B. T.A. 851.
Moro Realty Holding Corp., 25 B.T.A. 1135; 65 Fed. (2nd) 1013.
Grey Bull Corp., 27 B.T.A. 853.
Hugh MacRae Land Trust, 1 T.C. 899.

CONCLUSION

It is respectfully submitted that for the reasons above stated this petition for a Writ of Certiorari should be granted.

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CITATIONS.

CASES:

STATUTE:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 770

PORTER ROYALTY POOL, INC., A CORPORATION,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 191-217) is reported at 7 T. C. 685. The opinion of the Circuit Court of Appeals (R. 224-228) is reported at 165 F. 2d 933.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 3, 1948 (R. 223). The

petition for a writ of certiorari was filed on April 28, 1948. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the courts below correctly held that the taxpayer, regularly organized as a corporation and adjudicated by a state court to be the owner of certain oil royalty interests and entitled to the income derived from such interests, is taxable on the royalty income in question and is not simply an agent for its receipt.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 13 (As amended by Sec. 101, Second Revenue Act of 1940, c. 757, 54 Stat. 974). TAX ON CORPORATIONS IN GENERAL.

* * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation the normal-tax net income of which is more than $25,000 * * *

* * * *

(26 U. S. C. 1940 ed., Sec. 13.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for per-

sonal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U. S. C. 1940 ed., Sec. 22.)

STATEMENT

The taxpayer was organized as a corporation to effectuate a partial pooling of royalty interests of certain landowners who had leased their land for the drilling of oil and gas wells. At various dates prior to December 1, 1933, each of the lessors had entered into an agreement with certain promoters and trustees whereby the lessors assigned to the trustees one-half of their retained royalty interests in the oil and gas to be produced, it being agreed that the taxpayer corporation would be organized if commercially producing wells were brought in on any of the lands and that the trustees would transfer the royalty interests to the corporation, the lessors receiving shares of stock in the corporation. It was also agreed that twenty-five percent of the stock would be issued to the promoters in consideration of their services (R. 193-198). The taxpayer was duly incorporated in Michigan on

May 22, 1933 (R. 198). On June 16, 1933, the trustees transferred to the corporation the royalty interests which they had held in trust and, thereafter, the taxpayer issued its shares of stock to the persons entitled to them (R. 201). The stock certificates, as provided for in the taxpayer's by-laws, recited that they were issued in consideration for the royalty interests that were transferred, and that the assignors had agreed that good and merchantable title to the royalties had been conveyed (R. 199). The certificates further recited that if the title conveyed was not good or if liens were allowed to impair the corporation's title, the taxpayer possessed the right to apply dividends to perfect its title (R. 200). The taxpayer's by-laws also provided that, except for litigation or legal fees, its expenses for management and operation should not exceed $1,500 per year; its profits, except for the maintenance of a minimum cash balance of $200, were to be distributed by way of monthly dividends to its stockholders (R. 200-201).

Subsequently, certain of the fee owners refused to accept their stock and instituted litigation seeking a rescission of the pooling agreement on the ground that there had been fraud and misrepresentations in the organization of the pool, and a violation of the Michigan Blue Sky Laws in the organization of the taxpayer corporation (R. 201-202). This litigation was ultimately resolved in favor of the taxpayer corporation by the Supreme

Court of Michigan, which decreed that the taxpayer was the owner of the royalty interests transferred to it and that the landowner lessors were not. It was also ruled that the royalty income which had been impounded during the suit should be paid to the taxpayer (R. 202-206). The taxpayer expended $132,000 out of its income during the taxable years in question in conducting this litigation (R. 206-208).

The Tax Court determined deficiencies in income tax for the taxable years 1940 and 1941 (R. 217), which resulted from its holding that the taxpayer corporation was the taxable owner of the oil royalties which it received in those years. The Circuit Court of Appeals affirmed the decision of the Tax Court in all respects (R. 224-228).

ARGUMENT

1. The petition for a writ of certiorari seeks review of only one aspect of the decision below, namely, the holding (R. 227) that the taxpayer was the taxable owner of the oil royalties which it collected, and that it was not acting as a "conduit" or as an "agent" for someone else. The decision of the court below is altogether correct. To the extent that the taxpayer seems to argue that the facts of this case establish that it was acting as an agent for its stockholders (Pet. 15-18), or for the members of the original pooling agreement (Pet. 14-15), the Tax Court (R. 215) found the facts to

the contrary, and the Circuit Court of Appeals (R. 227) upheld the Tax Court saying that "this contention is without merit" and that it finds "no support in the agreements between the parties."

That the record supports, indeed, compels, the conclusion of the courts below is evidenced from the fact that the Supreme Court of Michigan had adjudicated that the taxpayer (R. 107) was the sole owner of the oil royalties and of the proceeds from the sale of the royalty oil and also (R. 108) that the taxpayer's stockholders had no right, title, or interest in the oil royalties or in the royalty income "save only in their capacity as stockholders * * * in accordance with the laws relating to corporations, all pursuant to the terms of the royalty pool agreement." As a result, the stockholders here had no interest in the taxpayer's income which would be different from that of a stockholder in the income of any other corporation. They, as all other stockholders, are only entitled to share in the corporation's profits by way of dividend distributions. These circumstances make applicable the decisions of this Court to the effect that the corporation is the entity which Congress has selected to be taxed on its income. *Moline Properties* v. *Commissioner,* 319 U. S. 436; *United States* v. *Joliet & Chicago R. Co.,* 315 U. S. 44; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415. The stockholders, in addition, will be taxable on such income as they may derive from dividend distributions.

The taxpayer points to nothing in the evidence which would have compelled the Tax Court to conclude that an agency or any other relationship existed between it and its stockholders, or between it and the pool members, and that they, rather than the taxpayer, are the taxable owners of the income in question. It should be parenthetically observed that the stockholders and the pool members are not identical groups of individuals. Since the taxpayer undeniably possessed full ownership under state law of the income producing property and of the income derived therefrom, it is difficult to comprehend how it possibly could have acted as an agent or in a fiduciary capacity with regard to property which it owned in all respects.

2. There is no conflict in decisions. *Moline Properties* v. *Commissioner, supra* (Pet. 18), holding that the corporation, and not its sole stockholder, is taxable on gains derived from property belonging to the corporation, is fully in accord with the decision below. *Commissioner* v. *Turney,* 82 F. 2d 661 (C. C. A. 5th), in which the taxpayer was not entitled to the income in question and which did not involve the relationship between a corporation and its stockholders, is clearly not in point. *112 West 59th St. Corp.* v. *Helvering,* 68 F. 2d 397 (App. D. C.), in which the beneficial ownership of the property was held not to be in the corporation, is not only distinguishable on its facts, but it is of doubtful authority since it was one of the cases

giving rise to the conflict in decisions on the basis of which certiorari was granted in the *Moline Properties* case, *supra*. See 319 U. S. 436, 437, fn. 1.

CONCLUSION

The petition for a writ of certiorari should be denied.

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